**RULES**
**OF**
**DEPARTMENT OF REVENUE**
**FRANCHISE AND EXCISE TAX DIVISION**

**CHAPTER 1320-6-1**
**FRANCHISE AND EXCISE TAX RULES AND REGULATIONS**

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**1320-6-1-.01 REPEALED.**

***Authority:*** *T.C.A. §§67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed May 14, 2003; effective July 28, 2003.*

**1320-6-1-.02 TAXPAYER (ENTITIES LIABLE FOR TAX)-DUE DATE-COMPUTER PREPARED TAX FORMS.**

(1) The combined franchise-excise tax return of all corporations, cooperatives, joint-stock associations and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee, is required to be filed on or before the first day of the fourth month following the close of the corporate fiscal year. Corporate returns which are based on a 52-53 week year will be due on or before the first day of the fourth month following the end of the month closest to the 52-53 week year end. The fact that such entities are inactive or have become inactive does not relieve them of the necessity of filing the return and paying at least the minimum $10.00 franchise tax. This requirement applies to domestic and foreign corporations. incorporated nor Tennessee but which is doing business in Tennessee shall file the franchise-excise tax returns as required herein.

(2) A franchise-excise tax return must he filed to coincide with each accounting period for which a federal return has been filed.

(3) To be accepted in lieu of the current forms provided by the Tennessee Department of Revenue for franchise-excise tax purposes, a franchise-excise tax return prepared by computer shall be a reasonable facsimile of current forms and shall contain all information required by the current forms.

(Rule 1320-6-1-.02, continued)

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-806, 67-44-817, 67-4-907, and 67-4-915.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.03 REPEALED.**

***Authority:*** *T.C.A. §§67-102(a).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed April 3, 1997; effective August 28, 1997.*

**1320-6-1-.04 INITIAL RETURN REQUIREMENTS.** Where there has been no closing of the books the taxpayer must file a return and pay the minimum franchise tax of $10.00. In preparation of the initial return where there has been no corporate closing prior to the end of the month subsequent to the expiration of a one year period from date of incorporation or domestication, only page one (1) of the tax form needs to be completed, and the minimum franchise tax must be paid. This return must be filed on or before the first day of the fourth month following the end of the month subsequent to the expiration of a one year period from date of incorporation or domestication.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-817, 67-4-907, and 67-4-915.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.05 SHORT PERIOD RETURN.**

(1) In the event of a corporate closing occurring within less than twelve (12) months of incorporation, domestication or commencing of business, the franchise tax of a domestic corporation will be prorated to cover the proportionate part of the year since the date of incorporation or the date of commencing business, whichever occurs first. The franchise tax of a foreign corporation will be prorated to cover the proportionate part of the year since beginning business in Tennessee. The excise tax may not be prorated.

(2) Annualization of rent paid will be required when determining the minimum measure of the franchise tax base in the event of a return covering less than one (1) year.

(3) A declaration of estimated excise tax shall not be required in any case if the taxable period is five (5) months or less but may be required if the taxable period is more than five (5) months. Annualization of the excise tax estimated to be due for the short period will be necessary to determine if such a declaration is required and, if so, the amount of each payment. When a required declaration for a period covering more than five (5) months but less than twelve (12) months is submitted, all estimated payments filing due within such short period and the payment due on the fifteenth (15th) day of the first month of the next taxable year will be paid in accordance with the provisions of T.C.A. §67-4-817, provided, however, that the payment due on the fifteenth (15th) day of the first month of the next taxable year will not be required if the interval between that date and the due date of the last quarterly payment required during such short period is less than (3) months. The amount due with each estimated excise tax declaration is the lesser of 25% of the excise tax liability shown on the prior year's twelve month return, or 25% of 80% of the current (short period) year's annualized excise tax. The various times when estimated tax payments are due for a return covering specific periods of less than twelve (12) months are as provided in §67-4-817(c)(1)(B).

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-817.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.06 NO CLOSING WITHIN TWO (2) YEARS.** Where no closing has been adopted within two (2) years from the end of the mouth of incorporation or domestication a taxpayer must report and pay the franchise tax according to the issue and outstanding stock or value of real and tangible personal property in Tennessee. whichever is greater, as of the end of the month, two (2) years from date of incorporation or domestication.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.07 REPEALED.**

***Authority:*** *T.C.A. §67-102(a).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Repeal filed April 3, 1997; effective August 28, 1997.*

**1320-6-1-.08 EXTENSION OF TIME.** Any request for an extension of time up to but not exceeding nine (9) months in which to file the combined franchise-excise tax return will be granted automatically provided the appropriate payment of tax is made on or before the statutory due date of the return and such payment is made on the form prescribed by the department or reasonable facsimile thereof. The appropriate payment will be an amount equal to the prior year's total payment unless a statement is furnished as to the reason the prior year's total payment is not a true indication of present liability or there was no liability for the preceding year. If there was no liability for the preceding year, the total payment must equal at least 90% of the final liability. In the case of tax rate changes which have occurred since the prior year's liability was computed, the computation of the appropriate payment based on the prior year's liability will be the prior year's tax measure times the tax rate in effect for the fiscal year for which the report is filed. If the total payment does not equal the prior year's liability (or changes) or does not equal 90% of the final liability, penalty shall be applicable to the total deficient amount of taxes. The term "total payment" includes both franchise and excise taxes. Any payment of Tennessee estimated excise tax made for the tax year or any other credits should be considered in determining the amount to be paid. The deficient amount of taxes shall bear interest at the rate prescribed by law.

***Authority:*** *T.C.A. §§67-1-1-02(a), 67-4-819, and 67-4-916.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed April 5, 1990; effective July 29, 1990.*

**1320-6-1-.09 PRIVILEGE PERIOD.** The franchise and excise taxes are accrued taxes and pay for a privilege period coextensive with the taxpayer's fiscal year closing or part thereof. However, any election as to privilege period made prior to July 1, 1963, will be deemed binding on the taxable entity. The corporate filing fee is prepaid and will pay for a privilege period not in excess of twelve (12) months following the date of close of the corporate fiscal year.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.10 FISCAL YEAR.** Once the taxpayer has elected a particular date as the close of its fiscal year. such closing may not be changed without prior approval of the Commissioner. A return will be required based on every fiscal closing of the corporate records. The excise tax will not be subject to proration. The franchise tax will be pro-rated to cover the proportionate part of the year covered by the return.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.11 SURRENDER OF CHARTER OR WITHDRAWAL.**

(1) The proper procedure to dissolve a Tennessee charter is as follows: (a) File an Intent to Dissolve, in writing, with the Secretary of State pursuant to T.C.A. §§48-1001 or 48-1002; (b) File all required tax returns along with payment of taxes with the Department of Revenue. The Secretary of State will record the Articles of Dissolution and/or the application to withdraw, as the case may be, when the

(Rule 1320-6-1-.11, continued)

Department of Revenue furnishes to such office a certification that the corporation has paid all taxes required by the Department of Revenue.

(2) A corporation will be required to file a return or returns, as the case may be, based on all fiscal closings. The excise tax will be based on all net earnings of the corporation and will not be subject to proration. The franchise tax will be determined by using the closing near date of surrender, withdrawal or a closing associated with or immediately preceding merger, liquidation or consolidation. In all cases corporations must submit schedule of liquidation, distribution or disposition of all assets.

***Authority:*** *T.C.A. §§67-1-102(a), 48-1001, 48-1001, 48-1007, and 48-1108.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled June 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.12 REPEALED.**

***Authority:*** *T.C.A. §67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed May 14, 2003; effective July 28, 2003.*

**1320-6-1-.13 FEDERAL INCOME REVISIONS.** All federal income revisions not previously reported must be shown in the appropriate section of the tax form.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.14 TREASURY STOCK.** For purposes of computing the franchise tax, T.C.A. §67-4-904 provides that "issued and outstanding" stock shall not include treasury stock. Such stock shall be excluded to the extent of its cost; however, treasury stock is not to be excluded in determining the filing fee for periods ending before July 1, 1983.

Example (1): A real estate developer is the lessee of a motel building and operates it with rooms available for the use of guests on a daily basis for a daily charge. The lease payment made by the real estate developer must be included in the minimum measure of the franchise tax with the multiple of 8 applied and without an offset for the payments received from motel guests.

Example (2): Same as (1), except that the real estate developer subleases the entire building to a motel chain which operates it as a motel. The sublease payments received from the motel chain are subrentals to the real estate developer and may be offset against the lease payments included in the real estate developer's franchise tax minimum measure.

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-904.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.15 INDEBTEDNESS-ADEQUACY OF CAPITAL.** The amount of indebtedness to be included pursuant to T.C.A. §67-4-905(c) shall not exceed the greater of the following amounts: (1) Excess of indebtedness over quick assets (cash, receivables, marketable investments), (2) Excess of book value (cost less accumulated depreciation) of capital assets (including inventories) per ending balance sheet of the return over net worth (including surplus reserves). If quick assets exceed the indebtedness to an affiliated corporation and the net worth exceeds the capital assets, the capital is adequate and no part of such indebtedness need be included. If capital is inadequate, a schedule of determination must accompany the franchise-excise tax return.

***Authority:*** *T.C.A. §§67-1-102 (a) and 67-4-905(c).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.16 RESERVES.** All reserves and allocations of surplus which do not represent definite and accrued legal liabilities or proper reductions in asset accounts must be included in determining the measure of the franchise tax. This shall include the entire reserves for bad debts as permitted under the federal Internal Revenue Code. Unrealized profits resulting from installment sales from personal property must be included as a part of surplus but the federal taxes that would be due on the reserve account alone, in the reported year, may be deducted.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.17 REPEALED.**

***Authority:*** *T.C.A. §67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6. 1984. Repeal filed May 14, 2003; effective July 28, 2003.*

**1320-6-1-.18 MINIMUM MEASURE OF FRANCHISE TAX.**

(1) As provided by T.C.A. §67-4-906 the measure of the franchise tax shall in no case be less than-the year end book value (cost less depreciation) of real and tangible personal property owned in this state plus the rental value of such property used but not owned in this state determined by multiplying the net annual rental of real property by eight (8), the net annual rental of machinery and equipment used in manufacturing and processing by three (3), the net annual rental of furniture, office machinery and equipment by two (2), and the net annual rental of delivery or mobile equipment by one (1).

(2) Rentals included in the minimum measure of the franchise tax may be offset by subrentals only to the amount of rentals paid. To qualify as subrental, the sublessee must have the same rights as the lessee with respect to use of the property.

(3) Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the franchise tax. Property in transit between the buyer and seller and shown on the books and records of the taxpayer in accordance with its regular accounting practices shall be included in the minimum measure of the franchise tax if it is destined to a Tennessee location.

(4) The value of any property while under construction must be included in the minimum measure of the franchise tax if there is actual utilization of such property by the corporation either in whole or in part. Actual utilization of the construction in progress will depend upon whether or not the construction in progress is utilized in the particular business conducted by the corporation.

Example (1): A manufacturer is in the process of building or expanding its facilities. The construction in progress would not actually be utilized in conducting the business of manufacturing until put in service by the corporation.

Example (2): A corporation is in the business of building and selling homes and the construction in progress will ultimately be for sale or rental. All of the construction in progress is utilized in conducting the business of home building.

Example (3): A corporation is in the business of operating motels and has a facility under construction. The construction in progress would not actually be utilized in conducting the business of operating motels until put in service by the corporation.

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-906.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.19 ADJUSTMENTS TO NET EARNINGS.**

(1) (a) S Corporations (26 U.S.C. Section 1361 et seq.). For purposes of the Excise Tax Law, S corporations shall calculate their net earnings as if they had not elected S status.

(b) For fiscal years ending on or after July 15, 1988, corporations electing S corporation status for federal purposes shall calculate net earnings for Tennessee excise tax purposes by starting with the corporation's ordinary income reported on its federal return and making the following adjustments:

1. Add income items passed through to shareholders under 26 U.S.C. Section 1366 to the extent such items would be included in federal taxable income had the corporation not elected S status;

2. Subtract expense items passed through to shareholders under 26 U.S.C. Section 1366 to the extent such items would be deducted from federal taxable income had the corporation not elected S status;

3. Any other adjustments necessary to calculate net earnings as though the corporation had not elected S corporation status.

The net earnings figure calculated above is then subject to the adjustments required by T.C.A. §67-4-805(b).

(c) S corporations shall include with each Tennessee excise tax return filed a copy of their Federal form 1120S filed with the Internal Revenue Service for the same tax year.

(2) Investment Tax Credit - Reduction in Basis of Assets. If a corporation is required to reduce the basis of its assets for federal tax purposes because it has taken an investment tax credit for federal tax purposes, the corporation shall also reduce the basis of its assets in the same manner for Tennessee excise tax purposes.

***Authority:*** *T.C.A. §§67-1-102, 67-4-803, and 67-4-805.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed March 9, 1990; effective April 23, 1990.*

**1320-6-1-.20 ACTUAL CHARITABLE CONTRIBUTIONS.** In determining net earnings for the purpose of computing the excise tax, T.C.A. §67-4-805 requires the charitable contributions deduction claimed under Section 170 of the Internal Revenue Code to be added to federal taxable income whereas §67-4-805 permits a deduction for actual charitable contributions made by the corporation during the fiscal year. The term "actual charitable contributions" means all bona fide contributions expensed and paid in a given year without regard to any percentage as required under federal law. The same criteria used for federal purposes in determining whether or not a contribution is a bona fide contribution is used by this state; however only the book basis of property donated to charity is as a deduction in determining net earnings for the purpose of computing the excise tax.

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-805.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.21 LOSE CARRYOVERS.**

(1) (a) Net operating losses incurred during fiscal years ending prior to March 31, 1982, may be carried forward three (3) years as net operating loss carryovers.

(Rule 1320-6-1-.21, continued)

(b) Net operating losses incurred during fiscal years ending on or after March 31, 1982, may be carried forward seven (7) years as net operating loss carryovers.

(2) The term "net operating loss" is defined by T.C.A. §67-4-805 of the excise tax law as the excess of allowable deductions over total income allocable to this state for the year of the loss. The loss is the same as that reported for federal income tax purposes before any operating loss adjustment and special deductions provided for in the Internal Revenue Code, and the loss is subject to the adjustments (additions and subtractions) provided for in §67-4-805. The amount of the loss that may be carried forward will be subject to the following adjustments:

(a) There shall be added to the net loss as determined for excise tax purposes, all non-business earnings, all interest, dividends excluded from net earnings pursuant to §67-4-805 and any other income excluded from net earnings pursuant to §67-4-805.

(b) With respect to corporations doing business both within and without Tennessee, adjustment shall be made to reflect the apportionment of the loss on the basis of business done within and without the State of Tennessee during the loss year. After making the adjustment as provided in subparagraph (a) hereof, the loss deductible for Tennessee excise tax purposes shall be that portion of the total loss apportioned to this state by the applicable statutory apportionment formula.

(c) The net loss so determined must be offset against the net earnings from business done within the state for the succeeding year, and if not completely offset by the net earnings from business done within the state for such year, the remainder of such net loss may be offset against the net earnings from business done within the state during the following year. In no case may any portion of such loss be carried forward and used to offset net earnings for any period beyond the applicable net loss carryover period as provided in paragraph (1) above, and in applying the loss carryovers where losses for more than one year are involved, the most remote year will be applied first.

(d) Each corporation is considered a separate entity; therefore, in the case of mergers, consolidations, etc., no loss carryovers incurred by the predecessor corporation will be allowed as a deduction from net earnings on the tax return of the successor corporation.

(3) In the case of a change in accounting period resulting in a situation where the three-year carryover period ends during a fiscal period, the remaining loss carryover will be prorated over the number of months in the accounting period before the loss carryover period expires. Example: Franchise-excise tax returns filed by a corporation show the following:

Calendar year 1979-Loss available for carryover $30,000.00
Six Months Ended 6/30/80-Net Earnings for Excise Tax purposes $3,000.00
Year Ended 6/30/81-Net Earnings for Excise Tax purposes S12,000.00
Year Ended 6/30/82-Net Earnings for Excise Tax purposes $9,000.00
Year Ended 6/30/83-Net Earnings for Excise Tax purposes $8,000.00.

The $30,000.00 loss carryover would be applied as follows:

$3,000.00 to 6/30/80
$12,000.00 to 6/30/81
$9,000.00 to 6/30/82
$3,000.00 (6/12 of remaining $6,000.00) to 6/30/83.

***Authority:*** *T.C.A. §§67-1-102 and 67-4-805.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective*

(Rule 1320-6-1-.21, continued)

*August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed March 9, 1990; effective April 23, 1990.*

**1320-6-1-.22 GROSS PREMIUMS TAX.** All insurance companies and self-insurers paying self-insurers' premium tax are permitted the option of expensing the amount of the gross premiums tax paid to this state, or as provided by T.C.A. §56-4-217 take the amount of the gross premiums tax paid to this state as a single credit against the sum total of franchise and excise taxes computed due. The gross premiums permitted as a credit is the tax paid based on the premiums collected (or imputed premium in the case of self-insurers) during the corresponding period covered by the franchise-excise tax return.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-808, and 56-4-217.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.23 BUSINESS AND NONBUSINESS EARNINGS.**

(1) (a) Business earnings are defined by T.C.A. §§67-4-804(1) as earnings arising from transactions and activities in the regular course of the taxpayer's trade or business and include earnings from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all earnings which arise from the conduct of the trade or business operations of a taxpayer are business earnings. For purposes of administration of T.C.A. §67-4-801 et seq., the income of the taxpayer is business earnings unless clearly classifiable as nonbusiness earnings.

(b) Nonbusiness earnings means all income other than business earnings.

(c) The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is not determinative of whether income is business or nonbusiness earnings. Income of any type or class and from any source is business earnings if it arises from transactions and activity occurring in the regular course of trade or business. Accordingly, the critical element in determining whether income is "business earnings" or "nonbusiness earnings" is the identification of the transactions and activity which are elements of a particular trade or business. In general, all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business.

(d) A taxpayer may have more than one regular trade or business in determining whether income is business earnings.

(2) Business and Nonbusiness Earnings: Application of Definitions. The following are rules and examples for determining whether particular income is business or nonbusiness earnings. (The examples used throughout these regulations are illustrative only and do not purport to set forth all pertinent facts.)

(a) Rents From Real and Tangible Personal Property. Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or incidental thereto and therefore is includable in the property factor under Rule 1320-6-1-.27.

Example 1: The taxpayer operates a multi-state car rental business. The income from car rentals is business earnings.

Example 2: The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earthmoving vehicles. The taxpayer makes short-term

leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business earnings.

Example 3: The taxpayer operates a multi-state chain of grocery stores. It purchases as an investment an office building in another state with surplus funds and leases the entire building to others. The net rental income is not business income of the grocery store trade or business. Therefore, the net rental income is non-business earnings.

Example 4: The taxpayer operates a multi-state chain of men's clothing stores. The taxpayer invests in a twenty-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining eighteen (18) floors are based to others. The rental of the eighteen (18) floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business income of the clothing store trade or business. Therefore, the net rental income is non-business earnings.

Example 5: The taxpayer constructed a plant for use in its multi-state manufacturing business and twenty (20) years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business earnings.

Example 6: The taxpayer operates a multi-state chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The net rental income received over the leased period is non-business and the gain (or loss) on the sale of the building is non-business earnings.

(b) Gains or Losses from Sales of Assets. As a general rule, gain or loss from the sale, exchange or other - disposition of real or tangible or intangible personal property constitutes business earnings if the property while owned by the taxpayer was used in the taxpayer's trade or business operations, unless such property is sold in a complete liquidation of the business and the business ceases all operations.

Example 1: In conducting its multi-state manufacturing business, the taxpayer systematically replaces automobiles, machines, and other equipment used in the business. The gains or losses resulting from those sales constitute business earnings.

Example 2: The taxpayer constructed a plant for use in its multi-state manufacturing business and twenty (20) years later sold the property at a gain while it was in operation by the taxpayer. The gain is business earnings.

Example 3: Same as two (2), except that the plant was closed and put up for sale but was not in fact sold until a buyer was found 18 months later. The gain is business earnings.

Example 4: Same as two (2), except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business earnings.

Example 5: Same as two (2), except that the plant was sold in complete liquidation of its assets when the business ceased all operations. The gun is non-business earnings.

Example 6: The taxpayer operated a multi-state chain of grocery stores. It owned an office building which it occupies as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an unrelated investment company under a five (5) year lease. Upon expiration of

the lease, taxpayer sold the building at a gain (or loss). The gain (or loss) on the sale is non-business income and the rental income received over the lease period is non-business earnings.

(c) Interest. Interest income is business earnings where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

Example 1: The taxpayer operates a multi-state chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business earnings.

Example 2: The taxpayer conducts a multi-state manufacturing business. During the year the taxpayer receives a federal income tax refund and collects a judgment against a debtor of the business. Both the tax refund and the judgment bore interest. The interest income is business earnings.

Example 3: The taxpayer is engaged in a multi-state manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage machinery replacement, etc. The moneys in those accounts are invested at interest. Similarly, the taxpayer temporarily invests funds intended for payment of federal, state and local tax obligations. The interest income is business earnings.

Example 4: The taxpayer is engaged in a multi-state money order and traveler's checks business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business earnings.

Example 5: The taxpayer is engaged in a multi-state manufacturing and selling business. The taxpayer has working capital and extra cash totaling $200,000 which it regularly invests in short-term interest bearing securities. The interest income is business earnings.

Example 6: In January the taxpayer sold all the stock of a subsidiary for $20,000,000. The funds are placed in an interest bearing account pending a decision by management as to how the funds are to be utilized. The interest income is non-business earnings.

(d) Dividends. Dividends are business earnings where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is related to or incidental to such trade or business operations.

Example 1: The taxpayer operates a multi-state chain of stock brokerage houses. During the year the taxpayer receives dividends on stock it owns. The dividends are business earnings.

Example 2: The taxpayer is engaged in a multi-state manufacturing and wholesaling business. In connection with that business the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business earnings.

Example 3: The taxpayer and several unrelated corporations own all of the stock of a corporation whose business operations consist solely of acquiring and processing materials for

(Rule 1320-6-1-.23, continued)

delivery to the corporate owners. The taxpayers acquired the stock in order to obtain a source of supply of materials used in its manufacturing business. The dividends are business earnings.

Example 4: The taxpayer is engaged in multi-state heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest bearing securities. Both the interest income and any dividends received are business earning.

Example 5: The taxpayer received dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business earnings.

Example 6: The taxpayer is engaged in a multi-state glass manufacturing business. It also holds a portfolio of stock and interest bearing securities, the acquisition and holding of which are unrelated to the manufacturing business. The dividends and interest income received are non-business earnings.

(e) Patent and copyright royalties. Patent and copyright royalties are business income where the patient or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business-operations or where the purposes for acquiring and holding the patent or copyright is related to or incidental to such trade or business operations.

Example 1: The taxpayer is engaged in the multi-state business of manufacturing and selling industrial chemicals. In connection with that business the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business earnings.

Example 2: The taxpayer is engaged in the music publishing business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These acquired copyrights are thereafter used by the taxpayer in its business. Any royalties received on these copyrights are business earnings.

Example 3: Same as example two (2), except that acquired company also held the patent on a type of phonograph needle. The taxpayer does not manufacture or sell phonographs or phonograph equipment. Any royalties received on the patent would be non-business earnings.

(3) Proration of Deductions. As a general rule, the allowable deductions for expense of a taxpayer are related to both business and non-business earnings. Such items as administrative costs, taxes, insurance, repairs, maintenance, and depreciation are to be considered. In the absence of evidence to the contrary, it is assumed that the expenses related to non-business rental earnings will be an amount equal to 50% of such earnings and that expenses related to other non-business earnings will be an amount equal to 5% of such earnings.

(4) The provisions of Rule 1320-6-1-.23 will be applied to all fiscal years ending on or after July 15, 1991.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-804, and 67-4-809.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment by Public Chapter 575; effective July 1, 1986. Amendment filed February 14, 1991; effective March 31. 1991.*

**1320-6-1-.24 APPORTIONMENT AND ALLOCATION.**

(1) Definitions.

(a) "Taxpayer" means any entity (corporation or otherwise) described in T.C.A. §§67-4-903 and 67-4-806 and rule 1320-6-1-.02 which is subject to corporate franchise and excise taxes.

(b) "Apportionment" refers to the division of business earnings between states by the use of a formula containing apportionment factors.

(c) "Allocation" refers to the assignment of non-business earnings to a particular state.

(d) "Business activity" refers to the transactions and activity occurring in the regular course of the trade or business of a taxpayer.

(2) (a) Application Of Law: Apportionment. If the business activity in respect to the trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer is taxable in another state, the portion of the net earnings (or net loss) arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with T.C.A. §67-4-811; provided, however, that businesses which come under the provision of T.C.A. §67-4-814 through 67-4-816 shall apportion their earnings as set out in such sections.

(b) Application Of Law. Allocation. Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its nonbusiness earnings or loss within or without this state in accordance with §67-4-810.

(3) Consistency And Uniformity In Reporting. In filing returns with this state, if the taxpayer departs from or modifies the manner in which earnings have been classified as business earnings or nonbusiness earnings in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-806, 67-4-810, 67-4-811, 67-4-814, 67-4-815, 67-4-816, and 67-4-903.* ***Administrative History:*** *Original rule certified June 7, 1974. Amendment filed August 13, 1974; effective September 12, 1977. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.25 TAXABLE IN ANOTHER STATE.**

(1) In General. Under T.C.A. §67-4-809 the taxpayer is subject to the allocation and apportionment of its net earnings if it has earnings from business activity that are taxable both within and without this state. A taxpayer's earnings from business activity are taxable without this state if such taxpayer, by reason of such business activity (i.e., the transactions and activity occurring in the regular course of its trade or business), is taxable in another state within the meaning of §67-4-809 (b). A taxpayer is taxable within another state if it meets either of two tests: (a) If by reason of business activity in another state the taxpayer is subject to one of the types of taxes specified in §67-4-809 (b)(1), namely: a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (b) If by reason of such business activity another state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether or not the state imposes such a tax on the taxpayer. A taxpayer is not taxable in another state with respect to its regular trade of business merely because the taxpayer conducts activities in such other state pertaining to the production of nonbusiness earnings.

(2) Taxable in Another State: When a Taxpayer is "Subject To" a Tax Under §67-4-809 (b)(1).

(Rule 1320-6-1-.25, continued)

(a) A taxpayer is "subject to" one of the taxes specified in §67-4-809 (b)(1) if it carries on business activities in such state and such states imposes such a tax thereon. Any taxpayer which asserts that it is subject to one of the taxes specified in §67-4-809(b)(1) in another state shall furnish to the Commissioner of Revenue of this state upon his request evidence to support such assertion. The Commissioner of Revenue of this state may request that such evidence include proof that the taxpayer has filed the requisite tax return in such other state and has paid any taxes imposed under the law of such other state; the taxpayer's failure to produce such proof may be taken into account in determining whether the taxpayer in fact is subject to one of the taxes specified in §67-4-809 (b)(1) in such other state.

(b) If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but

1. does not actually engage in business activities in that state, or

2. does actually engage in some business activity, not sufficient for nexus, and the minimum tax bears no relation to the taxpayer's business activities within such state, the taxpayer is not "subject to" one of the taxes specified within the meaning of §67-4-809 (b)(1).

Example: State A has a corporation franchise tax measured by net income, for the privilege of doing business in that state. Corporation X files a return and pays the $50 minimum tax, although it carries on no business activities in State A. Corporation X is not "taxable" in State A.

(c) The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activities may impose an income tax even though every state does not to so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in §67-4-809 (b)(1) which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in §67-4-809 (b)(1) in another state.

Example l: State A requires all nonresident corporations which qualify or register in State A to pay to the Secretary of State an annual license fee or tax for the privilege of doing business in the state regardless of whether the privilege is in fact exercised. The amount paid is determined according to the total authorized capital stock of the corporation; the rates are progressively higher by bracketed amounts. The statute sets a minimum fee of $50 and a maximum fee of $500. Failure to pay the tax bars a corporation from utilizing the state courts for enforcement of its rights. State A also imposes a corporation income tax. Nonresident Corporation X is qualified in State A and pays the required fee to the Secretary of State but does not carry on any business activity in State A (although it may utilize the courts of State A). Corporation X is not "taxable" in State A.

Example 2: Same facts as Example 1. except that Corporation X is subject to and pays the corporation income tax. Payment is prima facie evidence that Corporation X is "subject to" the net income tax of State A and is "taxable" in State A.

Example 3: State B requires all nonresident corporations qualified or registered in State B to pay to the Secretary of State an annual permit fee or tax for doing business in the state. The base of the fee or tax is the sum of (i) outstanding capital stock, and (ii) surplus and undivided profits. The fee or tax base attributable to State B is determined by a three factor apportionment formula. Nonresident Corporation X which operates a plant in State B, pays the required fee or tax to the Secretary of State. Corporation X is "taxable" in State B.

(Rule 1320-6-1-.25, continued)

Example 4: State A has a corporation franchise tax measured by net income for privilege of doing business in that State. Corporation X files a return based upon its business activities in the state but the amount of computed liability is less than the minimum tax. Corporation X pays the minimum tax. Corporation X is subject to State A's corporation franchise tax.

(3) Taxable in Another State: When a State Has Jurisdiction to Subject a Taxpayer to a Net Income Tax. The second test, that in §67-4-809(b)(2), applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. §§381-385. In the case of any "state" as defined in §67-4-804 (a)(7) other than a state of the United States or political subdivision of such state, the determination of whether such "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdiction standards applicable to a state of the United States applied in that "state." If jurisdiction is otherwise present, such "state" is not considered as without jurisdiction by reason of the provisions of a treaty between that state and the United States.

Example: Corporation X is actively engaged in manufacturing farm equipment in State A and in foreign country B. Both State A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and foreign country B.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-804, and 67-4-809.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.26 REPEALED.**

***Authority:*** *T.C.A. §67-1-102(a) and Acts 1999, Ch. 406, §2; effective July 1, 1999.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed May 14, 2003; effective July 28, 2003.*

**1320-6-1-.27 PROPERTY FACTOR.**

(1) In General. The property factor of the apportionment formula for the trade or business of the taxpayer shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of such trade or business. The term "real and tangible personal property" include land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency. Property used in connection with the production of nonbusiness earnings shall be excluded from the property factor. Property used both in the regular course of taxpayer's trade or business and in the production of nonbusiness earnings shall be included in the factor only to the extent the property is used in the regular course of taxpayer's trade or business. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case. The property factor shall include the average value of property includable in the factor. See Rule 1320-6-1-.29.

(2) Property Factor: Property Used For The Production Of Business Earnings. Property shall be included in the property factor if it is actually used or is available for or capable of being used during the tax period in the regular course of the trade or business of the taxpayer. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period (except inventoriable goods in process), shall be excluded from the factor until such property is actually used in the regular course of the trade or business of the taxpayer. If the property is partially used in the regular course of the trade or business of the taxpayer while under construction, the value of the property to the extent

(Rule 1320-6-1-.27, continued)

used shall be included in the property factor. Property used in the regular course of the trade or business of the taxpayer shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of nonbusiness earnings, its sale, or the lapse of an extended period of time (normally, five years) during which the property is held for sale.

Example (a): Taxpayer closed its manufacturing plant in State X and held such property for sale. The property remained vacant until its sale one year later. The value of the manufacturing plant is included in the property factor until the plant is sold.

Example (b): Same as above except that the property was rented until the plant was sold. The plant is included in the property factor until the plant is sold.

Example (c): Taxpayer closed its manufacturing plant and leased the building under a five-year lease. The plant is included in the property factor until the commencement of the lease.

Example (d): The taxpayer operates a chain of retail grocery stores. Taxpayer closed Store A, which was then remodeled into three small retail stores such as a dress shop, dry cleaning, and barber shop, which were leased to unrelated parties. The property is removed from the property factor on the date the remodeling of Store A commenced.

(3) Property Factor: Consistency In Reporting. In filing returns with this state, if the taxpayer departs from or modifies the manner of valuing property, or of excluding or including property in the property factor, used in returns for prior years. the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(4) Property Factor: Numerator. The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period in the regular course of the trade or business of the taxpayer. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without this state during leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under payroll factor or in the numerator of the state in which the automobile is licensed.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.28 PROPERTY FACTOR-VALUATION.**

(1) Valuation Of Owned Property.

(a) Property owned by the taxpayer shall be valued at its original cost. As a general rule "original cost" is deemed to be the basis of the property for federal tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc. If original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

(Rule 1320-6-1-.28, continued)

Example 1: The taxpayer acquired a factory building in this state at a cost of $500,000 and 18 months later expended $100,000 for major remodeling of the building. Taxpayer files its return for the current taxable year on the calendar-year basis. Depreciation deduction in the amount of $22,000 was claimed on the building for its return for the current taxable year. The value of the building includable in the numerator and denominator of the property factor is $600,000 as the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

Example 2: During the current taxable year, X Corporation merges into Y Corporation in a tax-free reorganization under the Internal Revenue Code. At the time of the merger, X Corporation owns a factory which X built five years earlier at a cost of $l,000,000. X has been depreciating the factory at the rate of two percent per year, and its basis in X's hands at the time of the merger is $900,000. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same as its basis in X's, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e., $1,000,000.

Example 3: Corporation Y acquires the assets of Corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under §334 (b)(2) of the 1954 Internal Revenue Code (i.e., stock processing 80 percent control is purchased and liquidated within two years). Under these circumstances, Y's cost of the assets is the purchase price of the X stock, prorated over the X assets.

(b) Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

(c) Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

(2) Valuation Of Rented Property.

(a) Property rented by the taxpayer is valued at eight times the net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer for such property, less the aggregate annual subrental rates paid by subtenants of the taxpayer. (See rule 1320-6-1-.35 (2)) for special rules where the use of such net annual rental rate produced a negative or clearly inaccurate value or where property is used by the taxpayer at no charge or rented at a nominal rental rate.) Subrents are not deducted when the subrents constitute business earnings because the property which produces the subrents is used in the regular course of the trade or business of the taxpayer when it is producing such earnings. Accordingly there is no reduction in its value.

Example 1: The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. Since the subrents are business earnings they are not deducted from rent paid by the taxpayer for the foodmarket.

Example 2: The taxpayer rents a 20-story office building and uses the lower two stories for its general corporation headquarters. The remaining 18 floors are subleased to others. The rental of the eighteen floors is separate from the operation of the taxpayer's trade or business. Since the subrents are nonbusiness earnings they are to be deducted from the rent paid by the taxpayer.

(b) "Annual rental rate" is the amount paid as rental for property for a 12-month period (i.e., the amount of the annual rent). Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the current tax period covers a period of less than 12 months (due, for example, to a reorganization or

(Rule 1320-6-1-.28, continued)

change of accounting period), the rent paid for the short tax period shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month to month basis.

Example 1: Taxpayer A which ordinarily files its returns based on a calendar year is merged into Taxpayer B on April 30. The net rent paid under a lease with five (5) years remaining is $2,500 a month. The rent for the tax period January 1 to April 30 is $10,000. After the rent is annualized the net rent is $30,000 ($2,500 X 12).

Example 2: Same facts as in Example 1, except that the lease would have terminated on August 31. In this case the annualized net rent is $20,000 ($2,500 X 8).

(c) "Annual rent" is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

1. Any amount payable for the use of real or tangible personal property, or any part thereof whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

   Example: A taxpayer. pursuant to the terms of a lease, pays a lessor $1,000 per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of $400,000. The annual rent is $16,000 ($12,000 plus one percent of $400,000 or $4,000).

2. Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and the other items.

   Example (i): A taxpayer, pursuant to the terms of a lease, pays the lessor $12,000 a year rent plus taxes in the amount of $2,000 and interest on a mortgage in the amount of $1,000. The annual rent is $15,000.

   Example (ii): A taxpayer stores part of its inventory in a public warehouse. The total charge for the year was $1,000 of which $700 was for the use of storage space and $300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is $700. "Annual rent" does not include incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc.

(d) Leasehold improvements shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-811.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.29 PROPERTY FACTOR: AVERAGING PROPERTY VALUES.**

(1) As a general rule the average value of property owned by the taxpayer shall be determined by averaging the values at the beginning and ending of the tax period. However, the Commissioner of

(Rule 1320-6-1-.29, continued)

Revenue may require or allow averaging by monthly values if such method of averaging is required to properly reflect the average value of the taxpayer's property for the tax period.

(2) Averaging by monthly values will generally be applied if substantial fluctuations in the values of the property exist during the tax period or where property is acquired after the beginning of the tax period or disposed of before the end of the tax period.

Example: The monthly value of the taxpayer's property was as follows:

| | |
|---|---|
| January | $ 2,000 |
| February | 2,000 |
| March | 3,000 |
| April | 3,500 |
| May | 4,500 |
| June | 10,000 |
| | $25,000 |
| July | 15,000 |
| August | 17,000 |
| September | 23,000 |
| October | 25,500 |
| November | 13,000 |
| December | 2,000 |
| | $95,000 |
| TOTAL | $120,000 |

The average value of the taxpayer's property includable in the property factor for the income year is determined as follows:

$120,000 ÷ 12 = $10,000

(3) Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in Rule 1320-6-1-.28 (b).

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.30 PAYROLL FACTOR.**

(1) In General.

(a) The payroll factor of the apportionment formula shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period.

(b) The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid.

Notwithstanding the taxpayer's method of accounting, at the election of the taxpayer, compensation paid to employees may be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under such method for unemployment compensation purposes. The compensation of any employee on account of activities which are connected with the production of nonbusiness earnings shall be excluded from the factor.

Example 1: The taxpayer used some of its employees in the construction of a storage building which, upon completion, is used in the regular course of taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of such wages is included in the payroll factor.

Example 2: The taxpayer owns various securities which it holds as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

(c) The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the federal Internal Revenue Code. In the case of employees not subject to the federal Internal Revenue Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the federal Internal Revenue Code.

(d) The term "employee" means any officer of a corporation, or any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common law rule, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

(e) In filing returns with this state, if the taxpayer departs from or modifies the treatment of compensation paid used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) Denominator. The denominator of the payroll factor is the total compensation paid everywhere during the tax period. Accordingly, if compensation paid to employees whose services are performed entirely in a state where the taxpayer is immune from taxation, for example, by Public Law 86-272, are included in the denominator of the payroll factor.

Example: A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In addition the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is immune from taxation by Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator- but not the numerator - of the payroll factor) even though the taxpayer is not taxable in State C.

(3) Numerator. The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation. The tests in T.C.A. §67-4-811(f) to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under such method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes constitutes compensation paid

(Rule 1320-6-1-.30, continued)

in this state except for compensation excluded under Rule 1320-6-1-.30. The presumption may be overcome by satisfactory evidence that an-employee's compensation is not properly reportable to this state for unemployment compensation purposes.

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-811.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.31 PAYROLL FACTOR: COMPENSATION PAID IN THIS STATE.**

(1) Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

(a) The employee's service is performed entirely within the state.

(b) The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The work "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(c) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

1. if the employee's base of operations is in this state; or

2. if there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or

3. if the base of the operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the employee's residence is in this state.

(2) The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points. The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

***Authority:*** *T.C.A. §67-101(2).* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977.*

**1320-6-1-.32 SALES FACTOR.**

(1) In General.

(a) T.C.A. §67-4-804(a)(6) defines the term "sales" to mean all gross receipts of the taxpayer not allocated under §67-4-810. Thus, for the purposes of the sales factor of the apportionment formula, the term "sales" means all gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business. The following are rules for determining "sales" in various situations:

1. In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods - or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the

(Rule 1320-6-1-.32, continued)

inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales, less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if such taxes are passed on to the buyer or included as part of the selling price of the product.

2. In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, "sales" include the entire reimbursed cost. plus the fee.

3. In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency, or the performance of equipment service contract, research and development contracts, "sales" includes the gross receipts from the performance of such services including fees, commissions. and similar items.

4. In the case of a taxpayer engaged in renting real or tangible property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.

5. In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

6. If a taxpayer derives receipts from the sale of equipment used in its business, such receipts constitute "sales." For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.

(b) In some cases certain gross receipts should be disregarded in determining the sales factor in order that the apportionment formula will operate fairly to apportion to this state the business earnings of the taxpayer's trade or business. For example, where substantial amounts of gross receipts arise from the sale of fixed assets used in the trade or business, such as the sale of a factory or plant, gross receipts will be excluded from the sales factor. In order to give proper recognition to the apportionment of business earnings (loss) in such instances, the net gain arising from the transaction or activity will be included in the sales factor.

(c) In filing returns with this state, if the taxpayer departs from or modifies the basis for excluding or including gross receipts in the sales factor used in returns for prior year, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) Sales Factor: Denominator. The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business.

(3) Sales Factor: Numerator. The numerator of the sales factor shall include the gross receipts attributable to this state and derived by the taxpayer from transactions and activity in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incidental to such gross receipts shall be included regardless of the place where the accounting records are maintained or the location of the contract or other evidence of indebtedness.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-804, and 67-4-810.* ***Administrative History:*** *Original rule certified June 7, 1974. Repealed and refiled July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.33 SALES FACTOR-SALES OF TANGIBLE PERSONAL PROPERTY.**

(1) Sales Of Tangible Personal Property Are In This State.

(a) Gross receipts from the sales of tangible personal property (except sales to the United States Government; see Rule 1320-6-1-.33 (2)) are in this state if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale.

(b) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

Example: The taxpayer, with inventory in State A, sold $100,000 of its products to a purchaser having branch stores in several states including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. $25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the "purchaser within this state" with respect to $25,000 of the taxpayer's sales.

(c) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

Example: The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of taxpayer's products shipped to the purchaser's warehouse in this state is property "delivered or shipped to a purchaser within this state".

(d) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

Example: A taxpayer in this state sold merchandise to a purchase in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is "in this state".

(e) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while enroute to a purchaser in this state, the sales are in this state.

Example: The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While enroute the produce is diverted to the purchaser's place of business in this state in which state the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

(2) Sales Factor: Sales Of Tangible Personal Property: To United States Government In This State. Gross receipts from the sales of tangible personal property to the United States Government are in this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. For the purposes of this regulation, only sales for which the United States Government makes direct payment to the seller pursuant to the taxes of a contract constitute sales to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government. However, sales made to a prime contractor will be considered sales to the United States Government where the prime contractor is authorized to act as agent for the United States Government and for this reason only qualifies to purchase under Federal Supply Contracts entered into between the taxpayer and the United States Government.

(Rule 1320-6-1-.33, continued)

Example (a): A Taxpayer contracts with General Services Administration to deliver X number of trucks which were paid for by the United States Government. The sale is a sale to the United States Government.

Example (b): The taxpayer as a subcontractor to a prime contractor with the National Aeronautics and Space Administration contracts to build a component of a rocket for $1,000,000. The sale by the subcontractor to the prime contractor is not a sale to the United States Government.

***Authority:*** *T.C.A. §67-1-102(a) and 67-4- 811.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.34 SALES FACTOR: SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY IN THIS STATE.**

(1) In General. T.C.A. §67-4-811(i) provides for the inclusion in the numerator of the sales factor of gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); under this section gross receipts are attributed to this state if the earnings producing activity which gave rise to the receipts is performed wholly within this state. Also, gross receipts are attributed to this state if, with respect to a particular item of income, the earnings producing activity is performed within and without this state but the greater proportion of the earnings producing activity is performed in this state, based on costs of performance.

(2) Earnings Producing Activity; Defined. The term "earnings producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, the earnings producing activity includes but is not limited to the following:

(a) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.

(b) The sale, rental, leasing, or licensing or other use of real property.

(c) The rental, leasing, licensing or other use of tangible personal property.

(d) The sale, licensing or other use of intangible personal property.

The mere holding of intangible personal property is not, of itself, an earnings producing activity.

(3) Costs Of Performance; Defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

(4) Application.

(a) In General. Receipts (other than from sales of tangible personal property) in respect to a particular earnings producing activity are in this state if:

1. the earnings producing activity is performed wholly within this state; or

2. the earnings producing activity is performed both in and outside this state and a greater proportion of the earnings producing activity is performed in this state than in any other state, based on costs of performance.

(Rule 1320-6-1-.34, continued)

(b) Special Rules. The following are special rules for determining when receipts from the earnings producing activities described below are in this state:

1. Gross receipts from the sale, lease, rental or licensing of real property are in this state if the real property is located in this state.

2. Gross receipts from the rental, lease or licensing of tangible personal property are in this state if the property is located in this state. The rental, lease, licensing or other use of tangible personal property in this state is a separate earnings producing activity from the rental, lease. licensing or other use of the same property while located in another state; consequently, if property is within and without this state during the rental, lease or licensing period, gross receipts attributable to this state shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during such period.

Example: Taxpayer is the owner of 10 railroad cars. During the year, the total of the days each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\left(\frac{10 \times 50 = 500}{3650}\right) \times \text{Total Receipts} = \text{Receipts Attributable to this State}$$

3. Gross receipts for the performance of personal services are attributable to this state to the extent such services are performed in this state. If services relating to a single item of income are performed partly within and partly without this state, the gross receipts for the performance of such services shall be attributable to this state only if a greater portion of the services were performed in this state, based on costs of performance. Usually where services are performed partly within and partly and partly without this state, the services performed in each state will constitute a separate earnings producing activity; in such case the gross receipts for the performance of services attributable to this state shall be measured by the ratio which the time spent in performing such services everywhere. Time spent in performing services includes the amount of the time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract, or other obligation, as for example, time expended in negotiating the contract, is excluded from the computation.

Example (i): Taxpayer, a road show, gave theatrical performances at various locations in State X and in this state during the tax period. All gross receipts from performances given in this state are attributed to this state.

Example (ii): The taxpayer, a public opinion survey corporation, conducted a poll by its employees in State X and in this state for the sum of $9,000. The project required 600 man-hours to obtain the basic data and prepare the survey report. Two hundred of the 600 man-hours were expended in this state. The receipts attributable to this state are $3.000.

$$\frac{200 \text{ man-hours} \times \$9{,}000}{600 \text{ man-hours}}$$

***Authority:*** *T.C.A. §§67-1-102(a) and 67-4-811.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.35 SPECIAL RULES.**

(1) In General.

(a) T.C.A. §§67-1-911 and 67-4-812 provide that if the allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Commissioner of Revenue may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

1. Separate accounting;

2. The exclusion of any one or more of the factors;

3. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

4. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's capital and net earnings for purposes of computing franchise and excise taxes. §§67-4-911 and 67-4-812 permit a departure from the allocation and apportionment provisions only in limited and specific cases. §§67-1-911 and 67-4-812 may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results under the apportionment and allocation provisions contained in the Franchise and Excise Tax Laws.

(b) As provided by law, the Commissioner of Revenue is given authority to require combined reports covering members of an affiliated group of corporations. In the event of inter-company activity in the manufacture, production or sales of products, the Commissioner may require a combined report if such is necessary to obtain an equitable and appropriate result.

(c) Application for relief must be addressed to the Commissioner of Revenue with the filing of a petition, in writing, setting forth the reasons why application of the statutory allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in this state. It must be shown by clear and cogent evidence that peculiar or unusual circumstances exist which would cause application of the said statutory provisions to work a hardship or injustice. Such application must also include a proposed alternative method of allocation or apportionment to be used by the corporation, and be submitted by the taxpayer on or before the statutory due date of the return. In the event that a variation from the statutory provisions is adopted, then such method shall continue in effect so long as the circumstances justifying the variation remain substantially unchanged. It shall be the duty of the taxpayer to furnish each subsequent year such information with the filing of its return as will establish the fact that the circumstances remain substantially unchanged.

(2) Property Factor. The following special rates are established in respect to the property factor of the apportionment formula:

(a) If the subrents taken into account in determining the net annual rental rate under rule 1320-6-1-.28(2)(b) produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the Commissioner of Revenue or requested by the taxpayer. In no case, however, shall such value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for such property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

(Rule 1320-6-1-.35, continued)

Example: The taxpayer rents a 10-story building at an annual rental rate of $1,000,000. Taxpayer occupies two stories and sublets eight stories for $1,000,000 a year. The net annual rental rate of the taxpayer must be less than two-tenths of the taxpayer's annual rental rate for the entire year, or $200,000.

(b) If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for such property shall be determined on the basis of a reasonable market rental rate for such property.

(3) Apportionment Of Common Carriers' Earnings. In lieu of the statutory three (3) factor formula of property, payroll and sales, taxpayers whose principal business in this state is that of a common carrier of persons or property for hire are required to apportion their earnings under the provisions of T.C.A. §67-4-814. Specific two (2) factor formulas are provided for railroads, motor carriers and pipelines which basically consist of a factor of gross receipts from operations on business beginning and ending in this state without entering or passing through any other state as compared to total gross receipts from such operations within and without this state and a factor of mileage (rail, highway and pipeline) owned and operated and leased and operated in this state as compared with the total of such mileage within and without this state. Taxpayers engaged in transporting passengers and property by both rail and motor are subject to a one (1) factor formula consisting of a combination of the mileage factors provided for railroads and motor carriers in §57-4-614. Reference should be made to §67-4-814 for specific definition of the apportionment factors, and the term "total mileage" as applied to common carriers shall be taken to mean franchise miles as provided by law.

(4) Apportionment Of Insurance Companies' Earnings. As provided by §67-4-816 Tennessee insurance companies shall pay the excise tax on net earnings proportioned to premiums on policies on persons and property in this state.

(5) Zero Denominator. In the use of any apportionment formula, where the denominator of a factor is zero, such factor must be eliminated entirely and the average then computed from the remaining factor or factors.

***Authority:*** *T.C.A. §§67-1-102(a), 67-4-905, 67-4-811, 67-4-812, 67-4-814, 67-4-815, 67-4-816, and 67-4-910.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984.*

**1320-6-1-.36 REPEALED.**

***Authority:*** *T.C.A. §§67-1-102(a), 13-28-11, and 67-4-808.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Repeal filed April 3, 1997; effective August 28, 1997.*

**1320-6-1-.37 ESTIMATED PAYMENTS OF EXCISE TAX.**

(1) Every corporation required by the provisions of T.C.A. §67-4-817 to make estimated quarterly payments of the excise tax, on or before the fifteenth (15th) day of the fourth (4th) month of its taxable year, shall file a declaration of its estimated excise tax in Tennessee for the taxable year. The declaration of estimated excise tax shall be an amount equal to the lesser of eighty percent (80%) of the total excise tax liability shown on the corporation's completed annual return to be due for the corporation's current taxable year or the total excise tax liability shown on the corporation's completed annual return to be due for the corporation's preceding taxable year of twelve (12) months.

(2) The estimated excise tax payment, as required by the provisions of T.C.A. §67-4-817, shall be an amount not less than the lesser of:

(Rule 1320-6-1-.37, continued)

(a) the total excise tax liability shown on the return of the corporation for the preceding taxable year, or

(b) eighty percent (80%) of the total excise tax liability shown on the return for the current taxable year.

(3) In the event that the corporation's completed annual return for the corporation's preceding taxable year covers a period of less than twelve (12) months, the excise tax due in such return shall be annualized in order to determine the amount to be paid with each quarterly estimated payment.

Example: For the five-month period beginning August 1, 1986 and ending December 31, 1986, the excise tax computed amounted to $1,500. This amount must be annualized in order to determine a minimum basis for the estimated annual tax liability for the twelve (12) months beginning January 1, 1987 and ending December 31, 1987. Computations are as follows:

$$\frac{\$1{,}500 \text{ (tax liability)} \times 12}{5 \text{ (tax period in months)}} = \$3600 \text{ (estimated annual liability)}$$

$$\frac{\$3{,}600 \text{ (estimated annual liability)}}{4} = \$900 \text{ (quarterly estimated payment)}$$

The total excise tax payment for the calendar year 1987 would have to be $3600 as computed above or 80% of the actual calendar year 1987 excise tax liability, whichever is less, to avoid accrual of penalty and interest for insufficient payment.

In the event that the return to be due for the corporation's current taxable year is to cover a period of less than twelve (12) months see rule 1320-6-1-.05(3).

(4) Estimated excise tax payment so determined shall be made by paying one-fourth (1/4) of the estimated amount on the fifteenth (15th) day of the fourth (4th) month of the current taxable year, one-fourth (1/4) of the estimated amount on the fifteenth (15th) day of the seventh (7th) month of the current taxable year, one-fourth (1/4) of the estimated amount on the fifteenth (15th) day of the tenth (10th) month of the current taxable year, and one-fourth (1/4) of the estimated amount on the fifteenth (15th) day of the first month of the subsequent taxable year.

(5) All estimated excise tax payments must be accompanied by the Tennessee estimated excise tax declaration or a copy thereof.

***Authority:*** *T.C.A. §§67-1-102 and 67-4-817.* ***Administrative History:*** *Original rule filed July 22, 1977; effective August 22, 1977. Amendment filed November 6, 1984; effective December 6, 1984. Amendment filed March 9, 1990; effective April 23, 1990.*

**1320-6-1-.38 CONSTRUCTING OR IMPROVING REAL PROPERTY.**

(1) In General - Corporations engaged in the business of constructing or improving real property for others shall report earnings as set out herein. Earnings from construction contracts begun prior to July 15, 1986, shall be reported on a separate accounting basis as provided at paragraph (2). Earnings from construction contracts begun on or after July 15, 1986, shall be reported on an apportionment basis as provided at paragraph (3). Business earnings from construction contracts for Tennessee shall be the sum of the net earnings calculated under paragraphs (2) and (3) of this rule.

(2) Separate Accounting - The provisions of this paragraph shall apply only to the construction or improvement of real property begun prior to July 15, 1986.

(Rule 1320-6-1-.38, continued)

(a) In the event a corporation has active in the tax year construction contracts begun prior to July 15, 1986 and also construction contracts begun after that date, overhead must be prorated. Overhead expenses for the tax year shall be prorated to contracts begun prior to July 15, 1986 by the ratio of the sum of direct construction costs incurred in the tax year for jobs began prior to July 15, 1986 as to the sum of direct construction costs incurred in the tax year for all contracts. Overhead expense ant direct construction costs for this purpose are as defined in subparagraph (b). The overhead expense thus obtained is then apportioned in as provided in subparagraph (b).

(b) Corporations engaged in the business of constructing or improving real property for others and required to report earnings on a separate accounting basis as provided by Section 67-4-815 will apportion overhead expenses to Tennessee jobs by a ratio of the sum of certain direct construction costs in Tennessee as to the sum total of such direct construction costs everywhere. Overhead expenses for this purpose are defined as all expenses (general, administrative, etc.) incurred during the fiscal year that cannot be applied directly to the job. Direct construction costs for this purpose shall be limited to the following:

1. Payroll directly incurred on the job,

2. Materials directly incurred on the job, and

3. Subcontracts directly incurred on the job.

Once the direct construction costs percentage is obtained on each job in progress or completed during the year, the percentages are then applied individually to total overhead expenses incurred during the period, and the sum of the amounts so computed is the overhead to be charged. Corporations reporting earnings on a completed contract basis will compute overhead in the above manner except the amount computed for each separate period a job is in progress will be deferred until the job is complete. Then the sum of the amounts computed for the entire period of the contract will be the total overhead deductible in the determination of taxable earnings. Other income related to construction operations which cannot be directly allocated to any state will be apportioned to Tennessee jobs in the above manner.

(c) In the event a corporation is not engaged exclusively in the business of constructing or improving real property for others but is engaged in other business activities, such as manufacturing and/or selling, both in Tennessee and elsewhere, the taxable earnings from such other activities conducted in the state will be derived from the use of the apportionment formula provided by Section 67-4-811 (a). There must be a separation of all contracting activities from all other business activities as to income, cost and expenses, and the sum of the net earnings derived from separate accounting and apportionment will be the taxable earnings subject to the excise tax. Where items of property, income or expense cannot be directly allocated either to contracting or to other business activities, such items will be apportioned on the basis of gross sales or gross receipts of the one business activity as to the sum of sales and gross receipts of all business activities.

(d) Corporations engaged in the business of constructing or improving real property for others both in Tennessee and elsewhere are required to use the formula provided by Section 67-4-910(a) for the purpose of apportioning capital stock. surplus and undivided profits subject to the franchise tax.

(e) Special forms are not provided for computation of net earnings by means of separate accounting. Taxpayers using separate accounting must attach to their franchise-excise tax returns a separate accounting income statement for Tennessee wherein direct Tennessee jobs and all overhead expenses are allocated to Tennessee jobs by the ratio of direct construction costs in Tennessee to direct construction costs everywhere. Applicable supporting

schedules, such as schedules of overhead expenses, direct Tennessee construction costs, and the direct construction cost ratio must accompany the franchise tax return when separate accounting is used. In cases where the completed contract method is used, schedules of direct construction costs on contracts in progress and overhead expenses allocated to Tennessee for that year by the direct construction cost ratio must accompany each return filed while Tennessee jobs are in progress even though such costs and expenses are deferred until the contract is completed. Such deferred costs and expenses shall be summarized on schedules accompanying the return filed for the period in which the contract is completed. If the corporation is engaged in constructing or improving real property for others, and is also engaged in other business activities both in Tennessee and elsewhere, separate income statements for each activity must accompany the franchise-excise tax return and supporting schedules must show how each item of income and expense was allocated to each type of business. The income statement for construction activities must then be broken down into the required Tennessee separate accounting income statement.

(3) Apportionment - The provisions of this paragraph shall apply only to the construction or improvement of real property begun on or after July 15, 1986.

(a) In General. Taxpayers having earnings from contracts for the construction or improvement of real property shall determine net earnings from such activity pursuant to this rule. Under T.C.A. §67-4-804, it must be determined which portion of the taxpayer's net earnings constitutes "business earnings" and which portion constitutes "nonbusiness earnings." Nonbusiness earnings are subject to allocation under T.C.A. §67-4-810. Business earnings are apportioned to Tennessee pursuant to the property, payroll and sales apportionment factors set forth in T.C.A. §67-4-811. In addition, the following special rules shall be applicable in determining and apportioning earnings from construction contracts.

(b) Business Earnings. The amount to be included in the tax year as business earnings from each construction contract shall be the same as that reported for federal tax purposes for the corresponding tax year.

(c) Apportionment Factors. Earnings from construction contracts begun on or after July 15, 1986 must be apportioned to Tennessee pursuant to the property, payroll and sales apportionment factors set forth in T.C.A. §67-4-811. Property, payroll and sales attributable to construction contracts begun prior to July 15, 1986 shall not be includable in the apportionment formula. Property, payroll and sales apportionment factors for the apportionment of income from construction contracts shall be determined as follows:

1. Property Factor. In general, the numerator and denominator of the property factor shall be determined as set forth in T.C.A. §67-4-811(b), (c) and (d), and rules 1320-6-1-.27 through .29, inclusive. However. the following special rules are also applicable.

(i) Rents paid for the use of equipment are included in the property factor at eight times the net annual rental rate even though such rental expense may be capitalized into the costs of construction.

(ii) "Rents paid" shall include rent expense in the income year for which it is deductible under the taxpayer's method of accounting for federal income tax purposes.

(iii) Rent expense which is capitalized to a particular construction project shall be attributed to the state in which the construction project is located.

2. Payroll Factor. In general, the numerator and denominator of the payroll factor shall be determined as set forth in T.C.A. §67-4-811 (e) and (f) and rules 1320-6-1-.30 and .31. However the following special rules are also applicable.

(Rule 1320-6-1-.38, continued)

(i) Compensation paid employees which is attributable to a particular construction project is included in the payroll factor even though capitalized into the costs of construction.

(ii) The payroll factor is computed by including compensation in the income year for which it is deductible under the taxpayer's method of accounting for federal income tax purposes.

(iii) Compensation paid to employees which is capitalized to a particular construction project shall be attributed to the state in which the construction project is located.

3. Sales Factor. In general, the numerator and denominator of the sales factor shall be determined as set forth in T.C.A. §67-4-811(g), (h) and (i) and rules 1320-6-1-.32 through .34, inclusive. However, the following special rules are also applicable:

(i) The sales factor is computed by including gross receipts in the income year for which it is includable under the taxpayer's method of accounting for federal income tax purposes.

(ii) Gross receipts derived from the performance of a contract are attributable to Tennessee if the construction project is located in Tennessee. If the construction project is located partly within and partly without Tennessee, the gross receipts, payroll and property factors attributable to Tennessee are based upon the ratio which construction costs for the project in Tennessee bear to the total of construction cost for the entire project or any other method, such as engineering cost estimates, which will provide a reasonable apportionment.

***Authority:*** *T.C.A. §§67-1-102 and 67-1-811.* ***Administrative History:*** *Original rule filed March 9, 1990; effective April 23, 1990.*

**1320-6-1-.39 DEDUCTION FROM THE MEASURE OF THE FRANCHISE TAX BASE FOR STOCK HELD IN ANOTHER CORPORATION.** As provided by T.C.A. §67-4-905(b), the value of stock held by any corporation in any other corporation paying the franchise tax and actually doing business in this state shall be deducted from the measure of the franchise tax of the first corporation. The value of the stock to be deducted is the amount at which the stock is stated on the books and records of the first corporation in accordance with generally accepted accounting principles. If a corporation is a financial institution member of a unitary business as defined in T.C.A. §67-4-804, the member may deduct the value of stock held in any other corporation, including another member of the group, if the other corporation or other member is paying the franchise tax and actually doing business in Tennessee.

***Authority:*** *T.C.A. §§67-1-102 and 67-4- 905(b).* ***Administrative History:*** *Original rule filed September 4, 1992; effective December 29, 1992.*